The importance of succession planning

As more of Asia’s first generation of wealth creators reach old age, the need for good succession planning is becoming increasingly important. The concept is gradually gaining ground within the region.

Proper planning lies at the heart of any successful endeavour. When it comes to ensuring the maintenance and growth of a family’s riches, this planning needs to focus upon succession.

Asia’s family wealth remains largely based in the hands of a first generation of entrepreneurs and business creators, who are usually actively involved in its management. The region’s demographics have supported this trend, with men and women often remaining capable and active well into their 80s.

However, the inevitable passage of time means the issue of how best to pass on the management and ownership of these riches is becoming more urgent.

“This is a pivotal time for Asian families and their businesses,” says Nisha Singh, a senior associate for the private client practice of Berwin Leighton Paisner. “Over 60% of listed businesses in South-east Asia are family-owned yet the sad truth is that many businesses in Asia do not survive beyond the first generation.”

A key first step is to gain a thorough understanding of the client’s situation. “It’s important to gain an understanding of the families you want to work with, and this requires asking them a lot of questions, not just immediately offering solutions,” says Markus Grossmann, managing director for Singapore, Hong Kong and New Zealand at Trident Trust. “For example, where is he a resident, what passport does he have, does he have children and if so how old are they? What are both his business and personal plans?”

One common point of tension is that the first generation figures who typically
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created the family’s wealth often have fixed ideas about how they wish to see this and their business continue. It is usually important to gain their assent to any succession plan.

“One of the most interesting as well as challenging aspects of succession planning is to get the patriarch or matriarch and their children to agree on a suitable long-term strategy for their businesses, investments and wealth,” says Woon Hum Tan, partner and head of the trust, asset and wealth management practice at Shook Lin & Bok.

Tan notes that different generations often have very different goals, plans and priorities, which can complicate wealth planning. “A person in his 40s would still be focussing on creating wealth; whereas a person in his 60s would be focussing on passing on wealth and business control.”

DIFFICULT DISCUSSIONS
Succession planning also inevitably involves discussing death, often a taboo topic among Asian cultures.

Experts say third party advisers can help bridge this cultural and familial gap.

“We can tell people innumerable stories where failure to plan for succession caused substantial difficulties for the next generation and used significant amounts of their wealth in legal fees,” says Richard Norridge, a partner and head of the Asia private wealth practice at Herbert Smith Freehills, who is based in Hong Kong.

“It is also easy to refer clients to the regular newspaper stories about families who were happy and harmonious, only to fall into bitter disputes due to lack of proper planning.”

One example that played out in the lurid lights of Hong Kong’s media was a battle over the estate of billionaire Nina Wang Kung Yu-sum, who died of cancer in 2006 at the age of 69. Originally Wang’s feng shui consultant and lover Peter Chan Chun-chuen claimed he was named sole recipient to her HK$83 billion (US$10.7 billion) estate under a 2006 will.

However, a court deemed the will to be a forgery, and Chan was sentenced to 12 years in prison in 2013.

Separately, Hong Kong’s Court of Final Appeal ruled in May 2015 that a charitable foundation established by Wang could not receive any part of her estate as “an absolute gift”, but could exercise trusteeship on the basis of her will.

Succession planning can reduce the risk of such disputes by ensuring a clear plan for the succession and ownership of family assets. It can also help families minimise probate costs on their assets and distribute wealth to younger generations in a measured manner they consider to be healthy.

The first point of call for a family seeking to arrange succession planning is a will, and power of attorney. Every family should take these basic steps.

Families also need to consider the risk of mental incapacity as first generation members grow older. Norridge says it can be a wise idea for senior family members to conduct frequent physical and psychiatric medical checks.
“This can be a delicate topic,” he admits. “We typically tell the client that we don’t mean to suggest they have a mental capacity issue or will pass away in the near future, but that at some point there will need to be a passing of the wealth, and it is best to make plans in advance.”

**SUCCESSION STRUCTURES**

The next common step is for families to ensure an orderly transition of assets through wealth structures, commonly family trusts.

Although the advent of anti-money laundering regulations and the coming introduction of the OECD’s Common Reporting Standards (CRS) has reduced the confidentiality of such structures, they still offer several advantages.

“Fundamentally trusts are still a good means to protect family wealth, and to protect people from themselves,” says Stephanie Jarrett, head of the wealth management practice group in Geneva for Baker & McKenzie.

“Some family members have mental, physical or other incapacities, or are simply not very good at managing things. Plus you can have gold diggers marrying into – or just hitching up with – families.

“Structuring helps to protect the family wealth in these situations and ensures it can be passed through the [succeeding family] generations.”

Trusts can also help family members arbitrage their tax exposure. They do so by ring-fencing assets from inheritance fragmentation, inheritance taxes, divorce or creditors, and ensuring the family wealth is passed to younger family members in measured amounts, to support education costs or ensure they are not spoiled.

“A trust will allow the private client to specify the beneficiaries, percentage of distributions, manner of entitlement and pay-outs and conditions for the pay-out,” says Shook Lin & Bok’s Tan. “The business control and philosophies on wealth and investments can be enshrined in the trust deed.”

The concept of trusts is no longer entirely alien to many Asian families, but regional clients remain less familiar with it than their US or European peers.

“European clients usually know exactly what they want, and within a one-hour meeting we could prepare for a structure to be set up. However, in Asia it often takes five to 10 meetings to get a client’s understanding.”

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**TRUST CONTROL**

One of the biggest concerns family patriarchs or matriarchs have with trusts is the fact they lose direct control of the assets placed into them.

“When you put into place a large trust or foundation, you are legally transferring those assets to the trustee,” says Jarrett.

“If you have US$200 million you are essentially transferring the legal title to those assets to a third party: exactly how comfortable do you feel about that? It is likely, you will want to give that step some thought.”
This was not helped by a lack of explanation from some private bank relationship managers (RMs).

“The biggest difficulty in the past was that some RMs, at the lower end of the market, sold trusts as a sort of product, almost a glorified bank account,” says Andrew Miller, head of the global trusts group at Walkers.

“They didn’t explain the reality to the client, which is that the assets will be controlled by the trustee, albeit that, with well-considered structuring, sensible checks and balances can be built into the structure.”

Jarrett agrees that there are ways for the family to keep responsibility for the trust well-weighted.

“You may well decide to put in place what we call protectors, or something similar, to counterbalance the trustee’s power,” she says.

“This might be constituted by two or three people who sit behind the trust and are either re-elected or replaced on a pre-defined basis, but while they are there they have the key powers to hire and fire the trustee.

“They are there to help consult with the family and ensure good governance. That should give the family comfort that the service provider acting as trustee has somebody keeping an eye on them.”

Lara Mardell, a senior associate at Ogier, an offshore jurisdictional legal advisory firm, cautions that families should always seek out quality independent tax advice before establishing trusts.

“Whatever the reason behind the structuring, it is important to take appropriate tax advice, to analyse the structure to ensure it will do what is intended, and to obtain relevant local advice where necessary,” she says.

ENCOMPASSING PLANS
Families that are comfortable with ensuring assets to trust structures and have disparate assets or potential beneficiaries, can consider more complex plans.

“If the private client is educated and sophisticated, he may take a longer term view and embark on a more complex succession plan with multiple tools and trust structures, prescribing principles and conditions for the transition of business control and wealth,” says Tan.

Nick Jacob, a partner at Wragge Lawrence Graham, says his firm is helping HNW families create succession plans to meet their business and family needs, to minimise potential disputes.

“We are working with clients to put together a governance structure for their business and family succession planning, to try and avoid family disputes and ensure their various assets are held together for the benefit of future generations,” he says.

“It is important to ensure that the family is well coordinated and tied together, that its members understand the structures so assets can pass seamlessly from one generation to the next.”

However, he cautions that this approach does not suit all families. Marcus Hinkley, a partner and head of the Singapore
office at Collas Crill, agrees. He notes there has been a growing trend for many advisers to recommend family governance structures, which can be extremely complex.

It’s also often preferable for Asian HNW families to employ relatively straightforward reserved powers trust structures to protect and pass on their assets, rather than attempting to conduct overly complex wealth structures.

“In a region where trust knowledge is relatively low, often simplicity is best,” he says.

UNDERSTANDING THE OPTIONS
The most important factor in succession planning is that family members fully understand the available wealth structuring options, which requires independent legal advice.

Additionally, the family should agree upon the objectives of family succession, and induct younger members into the process at an early stage so they understand and agree with these goals. This process of induction can be as early as when the children are aiming to pursue higher education, for example.

By bringing the younger members of the family in early, family elders have the best chance of ensuring that the values and family aims that they wish to instill are embraced by these younger family members, rather than them opting to either dilute or to entirely abandon them as soon as the family patriarch or matriarch has passed on.

“Younger generation members who are interested in finding out more about the patriarch, his legacy and philosophies, investments and wealth succession [should] be inducted into the investment committee or sub-committees and be sent for relevant formal training conducted at universities or private banks,” suggests Tan.

“It is always important to get the next generations involved early, so they can learn and become part of the system.”

It can also mean breaking family conventions. “Today many daughters of HNW families are well educated, financially independent and professional. They are much more involved with the family business and legacy matters and have often earned the confidence and trust of the patriarchs, their other siblings and professional advisers,” says Noor Quek, the founder and managing director of NQ International.

She notes the life knowledge of these female family members means they often bring new views. “They can often offer important insights into decision-making processes that have traditionally been dominated by male family members, and the gender diversity in this decision making process is an excellent form of corporate governance in itself.”

Families wishing to ensure their enduring success need to plan ahead, bring successive generations into well-structured goals and family processes, and decide on the best structures to support their succession plans.

Only through such procedures can today’s wealthy ensure they remain the same tomorrow.